

Chapter 4: Report of Survey of Local Governments Regarding Finance Trends and the Role of Annexations and Incorporations within the Framework of the Growth Management Act

In order to learn more about the fiscal situations of specific jurisdictions with respect to annexations and incorporations, a survey of local governments was undertaken in conjunction with the in-depth quantitative analysis of local finances. This survey was distributed by e-mail to the 6 counties and 25 cities selected for the study by the Office of Financial Management (OFM). Although there were a small number of jurisdictions that did not respond or were not interested in becoming involved with the study (non-respondents were Asotin County, Asotin, Tacoma, Deer Park, Spokane, and Selah), the vast majority of the jurisdictions (81%) responded to the survey. The participating jurisdictions were either interviewed by telephone by OFM staff or by members of the UW research team, or they submitted the survey questionnaire electronically. Appendix II contains the questionnaire utilized and the verbatim local government responses to the survey. The following sections summarize the jurisdiction responses and discuss broad themes emerging from the local government survey. It should be noted that copies of the transcriptions of the telephone surveys were sent to all responding jurisdictions, and they were requested to edit these transcriptions, and to permit publication of the verbatim responses included in Appendix II.

QUESTION 1: VERIFICATION OF BASELINE DATA

The first question in our survey was concerned with the accuracy of the financial, population, and annexation/incorporation data reported by the Office of Financial Management and the Office of the State Auditor. With a few minor exceptions, nearly all jurisdictions agreed with the reported OFM and Auditor's data. However, Clark County found that both the revenues and expenditures reported appeared to be roughly \$100 million dollars less than the numbers recorded by the county. Spokane County found one minor discrepancy in the reporting of annexed population of 80,702 in 2003 that was actually from an incorporation (Spokane Valley) rather than an annexation. In addition, the city of Fairfield reported inconsistencies in the population numbers reported by OFM resulting from erroneous Census estimates. Some jurisdictions, particularly the city of Harrah, found it difficult to compare the city's fiscal data with the Auditor's information because of the categories in which particular revenue and expenditure streams were grouped.

In order to develop perspectives on the fiscal impacts of annexations and incorporations on the case study local governments, the next portion of the survey was concerned with documenting perceptions of the impact of annexations and incorporations on revenue streams and expenditures.

QUESTION 2: REVENUE IMPACTS OF ANNEXATIONS AND INCORPORATIONS

The general trend emerging from the question regarding revenues is that the overall impact of annexations/incorporations on revenues of the jurisdictions in our study ranged from minor to negligible. Two-thirds of the jurisdictions surveyed reported that annexations and incorporations have had little to no impact on local revenues, while most of the other jurisdictions described small changes in revenue streams. However, there were some rapidly growing cities that had large revenue increases due to annexations or as a result of their incorporation. A significant factor shaping revenue flows for those experiencing annexation/incorporation related changes are the type of property annexed or incorporated. The jurisdictions that have annexed residential areas for development have seen revenue growth related to property taxes, sales taxes and real estate excise taxes. For instance, the city of Washougal has seen

positive revenue impacts stemming from the construction of new high-end housing and the city of Battle Ground has seen a secondary impact on revenues resulting from growth facilitated by annexations. Bonney Lake, on the other hand, believes that revenue impacts would be greater if they were able to annex land for commercial and industrial development, rather than the already developed residential areas that they have annexed over the study period. The city of Camas did annex an area for industrial development in 1997, however the revenue impacts have been negligible because until recently, only one business moved to the site. Port Angeles anticipates modest revenue increases to result from a pending 360-acre annexation area for commercial use. The city of Yakima has engaged in annexations almost annually, and it has developed spreadsheet models to forecast revenues (and expenses) associated with these annexations.

QUESTION 3: EXPENDITURE IMPACTS OF ANNEXATIONS AND INCORPORATIONS

In many ways, the expenditure impacts experienced by the jurisdictions in the study mirror the reported revenue impacts. While approximately 70% described virtually no change in expenditure streams resulting from annexations/incorporations, the remaining 30% reported changes in local expenditures. The most common theme for those reporting changes in expenditures are infrastructural and public works pressures generated from increased demand in service provision. The city of Port Angeles, for instance, expects to spend \$5.3 million on utility infrastructure investments after an upcoming annexation and Sequim predicts expenditure increases for utility and street maintenance. Similarly, several jurisdictions, including Puyallup, Washougal, Battle Ground, Yakima, and Bonney Lake, have faced expenditure increases related to the rising costs of police and/or fire provision in newly annexed areas. Again, the type of land annexed is important. For example, the city of Granger has not seen expenditure changes for service provision because they have annexed vacant land. The City of Yakima is able to manage expenditures it will make due to annexations by controlling the type of land use that occurs on vacant lands.

QUESTION 4: THE IMPORTANCE OF FACTORS OTHER THAN ANNEXATIONS AND INCORPORATIONS ON REVENUES AND EXPENDITURES

In the next portion of our survey, we asked local governments to assess the significance of other factors in impacting the fiscal situations of their jurisdictions in comparison to annexations and incorporations over the 1994-2003-study period. We asked the participants to rate the impacts of property tax changes (particularly Initiative 747), the reduction/elimination of the Motor Vehicle Excise Tax (MVET), general population growth, economic developments, and other factors on a scale of (1) Not important; (2) Somewhat unimportant; (3) Neutral; (4) Somewhat important; and (5) Extremely important. The results of this section reveal that the fiscal impacts of these other factors *overwhelmingly outweigh* the fiscal impacts resulting from the acts of annexations or incorporations taking place between 1994 and 2003. As described by Yakima County: “Initiative 747 and the repeal of the MVET have had a much bigger impact on our finances than annexations and incorporations. The general fund will lose \$25 million over a five year period due to these initiatives, and the road fund will lose about \$10 million.”

PROPERTY TAX IMPACTS (I-747) VERSUS ANNEXATIONS AND INCORPORATIONS

All participating jurisdictions rated the impacts of property tax changes, especially initiative 747, to be either somewhat important or extremely important. 61% rated property tax changes as extremely important and 39% felt that these impacts were somewhat important. University Place explained that they expect to lose approximately \$150 thousand per year and Pierce County as a whole has lost millions. Several jurisdictions, such as the city of Washougal, described their

heavy reliance on property taxes to raise revenues because of a weak retail base. The overall theme is that restraints on property taxes significantly impact the financial situations of the jurisdictions in the study, compared to revenue and expenditure impacts related to annexations or incorporations.

REDUCTION/ELIMINATION OF THE MOTOR VEHICLE EXCISE TAX VERSUS ANNEXATIONS AND INCORPORATIONS

Again, nearly every participating jurisdiction reported that the elimination of the Motor Vehicle Excise Tax (MVET) was either somewhat important or extremely important. Washougal remained neutral because they were not eligible for sales tax equalization. Approximately 70% of the participants rated this as extremely important while the other 30% reported that it was only somewhat important. The responses indicate that those most impacted by property tax changes rated this factor as slightly less important, while those less affected by changes in property tax were more significantly impacted by the reduction of the MVET. The city of Fairfield, for instance, explained that the elimination of the MVET reduces their revenues by about \$32 thousand a year and Port Angeles has seen a huge revenue reduction of \$300,000 per year. Similarly, Medical Lake reported that this has been the single most important factor in impacting their fiscal situation because they do not have a retail tax base. The City of Toppenish echoed this sentiment, pointing out that they are more reliant on MVET distributions than on property taxes. Pierce County explained that the impact is not as large for counties because they received a smaller portion of MVET distributions than cities.

GENERAL POPULATION GROWTH VERSUS ANNEXATIONS AND INCORPORATIONS

The responses regarding general population growth were less consistent and its significance was obviously directly tied to whether or not the participating jurisdictions are growth areas. For example, Clark County, Battle Ground, Bonney Lake, Washougal, Medical Lake, and Spokane Valley rated general population growth as extremely important, particularly in light of the rapid population increases they have recently witnessed. Bonney Lake, in fact, explained that they have grown at a rate of about 40-50% over the past few years. However, other jurisdictions did not rate this as a significant factor because population growth has been non-existent, modest, or manageable. Pierce County pointed out that while population has grown substantially, the increased expenditures have been balanced by increased revenues. The City of Yakima rated this factor not important, as they have little land available for infill, and most of their population growth has come from annexations.

ECONOMIC DEVELOPMENT VERSUS ANNEXATIONS AND INCORPORATIONS

Similar to general population growth, the responses regarding the importance of economic development were varied. While some jurisdictions, like Clarkston, Fairfield, and Steilacoom have not seen substantial economic growth, other locations, such as the cities of Bonney Lake, University Place, and Port Angeles, described economic development as being an extremely important factor. These areas have seen growth in revenues brought about through sales tax increases and have made commercial and industrial development a priority. Clark County describes economic development as extremely important, but in positive and negative terms:

“This has been quite important because of what has happened and what has not happened. The high rate of population growth has generated commercial growth to serve

the increased population. This has brought in more sales tax revenue. However, commercial development has its downside, too. Commercial development tends to require more sheriffs' service per acre than residential development. Also, there has been little industrial development in the county. Most jobs are still in Portland with little job-creating economic development happening in the county."

OTHER FACTORS COMPARED TO ANNEXATIONS AND INCORPORATIONS

Both the cities of Toppenish and Harrah noted the significance of their location on the Yakima Indian Reservation in impacting service provision, revenues, and their ability to grow. Several jurisdictions made reference to their response to question #5 that also addresses other factors critical to understanding local government finances over the study time period.

QUESTION 5: OTHER FACTORS DEEMED TO BE CRITICAL IN UNDERSTANDING LOCAL GOVERNMENT FINANCES BETWEEN 1994 AND 2003

The next question of the survey asked local governments to reflect on any other factors they feel are critical in understanding the finances in their jurisdictions over the study time period. The responses to this portion of the questionnaire were exceptionally diverse and in many cases relate specifically to the particular fiscal circumstances of the jurisdictions in question. Readers are directed to the responses to this question in Appendix II to gain perspective on the diversity of these responses. Despite the varied and wide-ranging nature of the responses to this question, however, a few common issues facing local governments are apparent. In particular, three broad themes emerged.

First, several jurisdictions reported difficulties resulting from unfunded state (and federal) mandates. These responses highlight the financial burden that such mandates place on local governments. As noted in the case of Spokane County, "State and court mandates have had important impacts. Incorporations have played a role, but these other factors have been more important." Clark County noted: "Unfunded state mandates have had a great impact on the county. Criminal justice costs related to legislation, the recently increased costs of indigent defense, the expense of complying with SEPA in county road building have all adversely impacted the county budget. Recent redistribution of mental health care funds is also a factor at both federal and state levels." The city of Yakima noted: "Federal and State unfunded mandates have had significant negative fiscal impacts on the City. For example, recent standards for storm water regulations were driven by west side precipitation levels, which make no sense in Yakima where precipitation levels are 20% of Westside precipitation levels. In many cases these standards also drive up the cost of planning." Similar comments were made by the cities of Forks, Port Angeles, University Place, and by Yakima County.

A second theme in response to this question is the further reiteration of the significance of sales tax equalization and other initiatives such as I-747 and I-695 on local finances. The cities of Clarkston, University Place, Fairfield, Granger, and Yakima, as well as Spokane County made comments on this topic. As reported by Granger:

"Initiatives and referenda have by far had the biggest impact on Granger. In the wake of I-695 and I-747 we had to close the municipal swimming pool and cut back on employment and other services. However, the demand for services actually increased. People don't realize that voting for the initiatives and referenda was going to reduce the funding for things they want."

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The third theme emerging from local governments' response to this question relates to the financial pressures arising from increasing insurance and health care costs. The cities of Yacolt, Puyallup, and Steilacoom, in addition to Pierce County, all described the increasing significance of rapidly growing health care costs to their budgets. In Puyallup it was noted that "Rising health care costs have put pressure on capital expenditures and may limit service levels in the future."

As noted above, the responses to this question were quite diverse, and while these three topics were mentioned multiple times, there are many other observations made by the local governments that are recorded in Appendix II.

QUESTION 6: DECISIONS TO REJECT ANNEXATIONS DUE TO PERCEIVED COSTS OF SERVICE EXCEEDING PERCEIVED REVENUES

The next question asked jurisdictions whether or not they have considered annexations or incorporations, but have not pursued them because of expected costs exceeding expected revenues. This question did not apply to the six counties included in this survey, as they cannot annex. The majority of respondents answered no to this question (19 of the 25 local governments, with two providing ambiguous answers). However, four of local cities agreed that this had been the case in their jurisdictions. The city of Battle Ground has, for instance, considered delaying a proposed annexation, although at this point in time they have not actually postponed or denied any particular annexation. Bonney Lake has deferred the annexation of a particular residential area because of the cost of necessary infrastructural updates. Similarly, Steilacoom has not annexed a residential area because the cost of service provision would outweigh revenue gains.

QUESTION 7: THE USE OF IMPACT FEES ALLOWED UNDER THE GMA

Participating jurisdictions were asked whether or not they have imposed impact fees as allowed by RCW 82.02 for cities and counties that are required to plan under the Growth Management Act, and if so, how those impact fees have been utilized. Most respondents (15 out of 24) are using impact fees. Those imposing impact fees reported most commonly utilizing those fees for parks, open space, and recreation facilities, for school facilities and renovations, and to a lesser extent, for street and road improvement. In general, those local governments imposing impact fees have used them to offset or help pay for growth. Nine of the respondents have not imposed impact fees; however several of those jurisdictions are considering impact fees as a way to share to the costs of growth and development.

QUESTION 8: OTHER COMMENTS OFFERED BY LOCAL GOVERNMENTS

Most respondents did not answer this last question. Those responding to it tended to echo themes already covered, spoke to matters particular to their jurisdiction, or made other general observations. A sampling of these comments follows. The City of Medical Lake addressed their special situation with regard to Eastern State Hospital, which creates costs for the city that they argue they are not compensated for. The City of Steilacoom expressed concern about impacts of decisions by the Puget Sound region Growth Management Hearing Board. The City of Yakima commented on financial relationships with school districts. The City of Harrah emphasized the importance of the County Council of Governments in coordinating land use. The City of Bonney Lake observed how diverse the jurisdiction was becoming in relation to its rapid growth, and the challenges that this posed for developing the city. Other comments addressed shifting methods for sales tax distributions, and the growing importance of federal and state intergovernmental transfers.